

Agenda Report

September 30, 2013

TO: Honorable Mayor and City Council
THROUGH: Finance Committee
FROM: Director of Finance
SUBJECT: RESPONSE TO LOS ANGELES COUNTY CIVIL GRAND JURY FINAL REPORT 2012-2013

RECOMMENDATION:

It is recommended that the City Council authorize the Mayor to transmit the proposed responses, which appear in the body of this agenda report, to the Presiding Judge of the Los Angeles County Superior Court for those portions of the Civil Grand Jury's Final Report 2012-2013 dealing with the City of Pasadena in order to comply with the statutory requirements when a Grand Jury report is issued.

EXECUTIVE SUMMARY:

The Los Angeles County Civil Grand Jury serves as a public "watch-dog" by examining the operations of various government agencies within Los Angeles County. Each year the Grand Jury undertakes a number of investigative reports which are combined into a single annual report.

For its 2012-2013 Annual Report, the Grand Jury published 12 investigative reports. One of these investigations is related to all 88 cities in Los Angeles County. This report expands on the report issued in the prior year which reported on 23 of the 25 charter cities in Los Angeles County for potential abuses.

The Civil Grand Jury report on Cities of Los Angeles County focuses on the following four areas: Fiscal Health, Governance, Financial Management, and Compensation (Attachment 1). The required responses identified in the Grand Jury report are reflected in Exhibit 12. Although the report contains 17 recommended actions, only 6 of the recommendations require responses from the City of Pasadena; however, based on recommendations from County Grand Jury staff, responses to all 17 recommendations have been included.

Given the operational differences between various cities, it is extremely difficult to obtain an “apples to apples” comparison of the fiscal health of cities by simply using the numbers in the comprehensive annual financial report (CAFR). The transmittal letter, notes to the CAFR, management discussion and analysis, and the statistical section must be reviewed in conjunction with review of the numbers. For example, cities typically collect revenues in one year that, because of project timing, are spent in subsequent years. Under this situation, the unspent revenues are accumulated in fund balance or retained earnings until needed. Consequently, the actual revenue collected and the actual expenditure would be in different fiscal years. Using the Grand Jury’s methodology, in the year that the expenditure is made, the CAFR would reflect higher expenditures than revenues. This is simply a timing difference and has nothing to do with a city’s fiscal health. The Grand Jury’s report, however, penalizes for this situation. Additionally, at least in the City of Pasadena’s case, the Grand Jury’s report does not take into account the accounting changes required by the dissolution of redevelopment. FY 2012 was the year that the Pasadena Community Development Commission (PCDC) was terminated by operation of state law as of January 31, 2012, and the Successor Agency acquired all the assets of PCDC. These are treated as separate entities and accounted for using a different basis of accounting. This required large changes to beginning fund balances and then large adjustments to reflect elimination of advances between the City and PCDC. This did not impact Pasadena’s fiscal health. The net impact on the operational bottom line is neutral. Consequently the conclusions reached by the Grand Jury report are incorrect in regards to FY 2012. When adjustments are made for this anomaly, Pasadena’s financial condition actually improved between FY 2011 and FY 2012.

BACKGROUND:

Last year, the Los Angeles County Civil Grand Jury issued an investigative report on 23 Charter Cities in Los Angeles County. Los Angeles and Long Beach were not evaluated due to their size. On September 24, 2012, the City took action to approve a response to the Grand Jury’s report in regard to the City of Pasadena’s findings. In January 2013, City staff completed a survey regarding the status of the City’s responses and actions taken. The results of the surveys to the 23 charter cities studied last year are presented as Appendix D of this year’s report (the City of Pasadena is on page D-2). On June 28, 2013, the Civil Grand Jury issued its report on all 88 cities in Los Angeles County.

The methodology used by the Grand Jury was to obtain and review city Comprehensive Annual Financial Reports (CAFRs), develop key financial ratios, and rank cities. They developed surveys for three groups of cities; the charter cities previously evaluated, the two charter cities not previously evaluated, and the 63 general law cities. They evaluated the responses and reviewed the reasonableness of compensation information which each city submits to the State Controller annually. They were assisted by a certified public accounting firm. The Grand Jury divided the study and results into the following categories:

- Fiscal Health
- Governance and Financial Management Best Practices
- Financial Management Practices
- Employee Compensation

The report provides 12 exhibits which are tables that present and rank various key financial indicators. Exhibit 2, "Employees with Compensation over \$200,000" in FY 2011, reports a quantity not a ranking.

Overview of Grand Jury Data Contained in Exhibits:

Many of the exhibits are self-explanatory; however, it is believed that the methodology is flawed which leads to misleading and/or incorrect conclusions. Some of the tables use the term "net revenue" or "net revenue percent" which are not fully representative of the results of operations of all governmental funds as they are only revenue and expenditure driven and omit "other financing sources (uses)" which include transfers in. For example, Pasadena's Capital Projects fund is largely funded by transfers in from funding sources for CIPs. Two tables include \$12.8 million of expenditures over revenues, but omit \$13.1 million of net transfers in for capital improvement projects. Additionally, the tables do not account for intentional use of fund balance that contains an accumulation of previously collected revenues for expenditures made in subsequent years.

Regarding General Fund Balance indicators, the FY 2011 numbers are correct; however, the FY 2012 numbers are incorrect. While the total General Fund balance is correct, the unassigned negative fund balance of \$40,129,137 should actually be a positive balance of \$7,121,190. This correction is related to the dissolution of the PCDC and the uncertainties related to the accounting treatment of advances from the General Fund, industry wide accounting ambiguities, and the legal status due to pending litigation. This has no effect on the fiscal health of Pasadena. Adjusting for this anomaly changes the ratio for the FY 2012 unassigned fund balance as a percent of expenditures to change from (23.1 percent) to a positive 4.1 percent and moves the City ranking from 75 to 61.

City's Response:

Pursuant to California Penal Code Sections 933(c) and 933.05 a written response to each of the findings and recommendations contained in the Grand Jury report is required no later than ninety days after publication by October 1, 2013. As part of the response, cities are required to indicate whether they agree, or wholly or partially disagree, with the finding. Regarding recommendations, the City is to indicate if it has been implemented, has not been implemented, requires further study, or will not be implemented. Explanations and timelines are expected for items not yet implemented. It should be noted that the City is taking the approach of responding to all findings and

recommendations even though the recap (Exhibit 12) only requires responses in six areas. Accordingly, staff is recommending that the following responses be transmitted under a cover letter from the Mayor.

Grand Jury Recommendations and City's Responses:

A. Fiscal Health

Grand Jury Finding 1: Most cities expended more than they received in revenues during FY 2012.

Proposed Response: The City of Pasadena agrees with the general finding, but notes that Tables 3 and 4 which support this finding in regards to the City of Pasadena, does not tell the whole story. Revenues collected from prior years, for example, which are intended to be used for FY 2012 expenditures, are not identified or taken into account in this finding. This situation results in simply a timing issue and would not necessary impact fiscal health. Additionally, this finding does not reflect net other financing sources/uses which result from transfers. These factors combine to make the conclusions of the report misleading.

Grand Jury Finding 2: Most cities' total net assets and general fund balances declined during FY 2012, and several cities' ratios of total net assets to total liabilities are lower than desirable.

Proposed Response: The City of Pasadena agrees with the general finding, but notes that Pasadena was in the desirable range with ratios greater than 2.0 which is improved from FY 2011

Grand Jury Recommendation 1: All cities should adopt financial planning, revenue and expenditure policies to guide city officials to develop sustainable, balanced budgets.

Proposed Response: The City of Pasadena agrees with the recommendation. These concepts are already part of the City's financial forecasting and planning methods and most are included in the City's formal Fund Balance Policy. Some further analysis is required to formalize any components which are not already part of an existing written policy. It is anticipated that this will be completed within six months. This has been partially implemented.

Grand Jury Recommendation 2: All cities reviewed in this report should develop a balanced budget and commit to operate within budget constraints.

Proposed Response: The City of Pasadena agrees with the recommendation and has implemented the recommendation.

Grand Jury Recommendation 3: All cities should not use one-time revenue to fund recurring or on-going expenditures.

Proposed Response: The City of Pasadena agrees with the recommendation. These concepts are already part of the City's financial budgeting, forecasting, and planning methods. This recommendation has been implemented.

Grand Jury Recommendation 4: All cities should adopt a method and practice of saving into a reserve or "rainy day" fund to supplement operating revenue in years of shortfall.

Proposed Response: The City of Pasadena agrees with the recommendation and the City Council approved a Fund Balance Policy on August 15, 2011 which establishes a policy and method of increasing the General Fund balance. This policy calls for adherence to the Government Finance Officers Association (GFOA) Best Practices by increasing our General Fund balance from 10 percent currently to 20 percent after FY 2014. The rate of 20 percent is above the 16.67 percent (two month) minimum recommended by GFOA. The FY 2012 General Fund balance committed to the General Fund Emergency Contingency when combined with the General Fund unassigned fund balance as adjusted for redevelopment dissolution as previously discussed, is 13.3 percent of appropriations. Additionally the City's five-year forecast is used to monitor fund balance with a goal of saving and rebuilding fund balance in favorable years. The policy change has been adopted. We are in compliance with our stated policy with the accumulation of fund balance progressing towards the City's stated target for FY 2015.

B. Governance and Financial Management Best Practices

Regarding this category, all findings and recommendations have been met and one response is proposed for all at the end of this section.

Grand Jury Finding 1: Most cities have developed strategic plans to provide appropriate strategic focus and direction for the City.

Grand Jury Finding 2: Most cities have developed performance measures to demonstrate the results of their organizational activities and goals.

Grand Jury Finding 3: All cities stated they have a formal policy agreement, or other documents that define the role of city council and city executive.

Grand Jury Finding 4: Most city councils have established specific goals for executives at least annually.

Grand Jury Finding 5: Most cities have adopted a "Conflict of Interest" code.

Grand Jury Finding 6: Most cities have adopted an “Investment” policy.

Grand Jury Finding 7: Most cities published their financial reports or CAFR to their website.

Grand Jury Recommendation 1: Cities should develop and adopt a strategic plan that articulates the mission, vision, core values, and priorities for the city.

Grand Jury Recommendation 2: Cities should develop and report on performance measures or indicators to evaluate outcomes. These performance measures should be quantified, focused on outcomes, and information should be provided for several years to allow evaluation of progress over time.

Grand Jury Recommendation 3: City councils should develop specific annual goals for the city’s executive.

Grand Jury Recommendation 4: City councils should conduct meaningful evaluations of the city’s executive at least annually.

Grand Jury Recommendation 5: Cities should publish their financial reports or CAFRs on their city’s website.

Proposed Response for Findings 1 through 7 and Recommendations 1 through 5: The City of Pasadena agrees with these findings and recommendations and is pleased to report (as acknowledged in the report) that it has already implemented all findings and recommendations in this category. Previous responses and evidence submitted has demonstrated compliance.

C. Financial Management Practices

Grand Jury Finding 1: Few cities formally establish an audit committee responsible for monitoring and overseeing financial reporting.

Proposed Response: The City of Pasadena agrees with the finding and has a City Charter requirement that the Finance Committee, a standing committee of the City Council, perform the functions of an audit committee.

Grand Jury Finding 2: All cities require their auditors to comply with independence standards and most selected their auditors through a competitive process. Most also precluded the auditor from providing non-audit services.

Proposed Response: The City of Pasadena agrees with the finding with a minor exception regarding non-audit services. The City will only utilize its auditor for non-audit services after full and appropriate review and compliance with

current professional standards which provides guidance and restrictions in this area.

Grand Jury Finding 3: Many cities could improve their documentation and maintenance of accounting policies and procedures.

Proposed Response: The City of Pasadena agrees with the finding. The City has extensive written policies and has, in many individual areas, reviewed and updated specific policies and procedures. The City is committed to updating our accounting policies and procedures. Pasadena's fund balance policy was updated in 2011, a consultant has reviewed financial operations and made recommendations, and a consultant will be used to assist with a comprehensive review and full documentation of accounting policies and procedures. As the City moves forward with an Enterprise Resource Planning (ERP) solution, business practices and their related documentation will also be reviewed and updated.

Grand Jury Finding 4: Many cities could improve their policies and procedures for reporting fraud, abuse, and questionable practices.

Proposed Response: The City of Pasadena agrees with the finding and has taken a number of steps to create a fraud, waste, and abuse hotline. It is anticipated that this hotline will be available in about one month.

Grand Jury Finding 5: Many cities could improve their internal control procedures over financial management.

Proposed Response: The City of Pasadena agrees with the finding and, although policies and procedures are in place, improvements can always be made. This will also be part of the actions discussed in Finding #3.

Grand Jury Finding 6: Most cities did not have a formal internal audit function.

Proposed Response: The City of Pasadena agrees with the finding. The City is handling the internal audit function under the direction of the Director of Finance and the Controller. External auditors have been engaged to perform a number of internal audits in specific areas. In the last year, five of these audits have been conducted focusing on purchasing card use and cash handling. Currently two audits are underway. These audits are selected and prioritized based on an assessment by the Director of Finance and Controller. Additionally, existing Finance Department accounting staff are performing internal audits. The City intends to expand the use of existing staff to perform more internal audits.

Grand Jury Finding 7: Many cities' policies and procedures governing General Fund unrestricted fund balance could be improved.

Proposed Response: The City of Pasadena agrees with the finding and has adopted a General Fund balance policy which complies with GFOA recommended best practices as discussed in the response to recommendation #4.

Grand Jury Finding 8: All cities maintained an adequate accounting system. Most issued timely financial statements and a CAFR in compliance with standards, and most made the CAFR readily accessible to the general public on their website.

Proposed Response: The City of Pasadena agrees with the finding and has an adequate accounting system and the City's CAFRs for fiscal years 2003 through 2012 are readily available on the City's website. Additionally, the City has begun the Enterprise Resource Planning (ERP) system replacement process and will be implementing a fully integrated, robust accounting solution in the next few years.

Grand Jury Recommendation 1: Cities should formally establish an audit committee making it directly responsible for the work of the independent auditor.

Proposed Response: The City of Pasadena agrees with the recommendation and has a City Charter requirement that the Finance Committee, a standing committee of the City Council, performs the functions of an audit committee. This recommendation has been fully implemented for many years.

Grand Jury Recommendation 2: Cities that do not currently select the auditor through a competitive process should do so.

Proposed Response: The City of Pasadena agrees with the recommendation and selects its auditor through a competitive process. This selection was most recently done in 2009 and in 2011. This recommendation has been fully implemented for many years.

Grand Jury Recommendation 3: Cities that allow the auditor to provide non-audit Services should ensure appropriate review and approval of services.

Proposed Response: The City of Pasadena agrees with the recommendation and will only utilize its auditor for non-audit services after full and appropriate review and compliance with current professional standards which provide guidance and restrictions in this area. This recommendation has been implemented.

Grand Jury Recommendation 4: Cities should review and update accounting policies and procedures to ensure they are appropriately detailed and define the specific authority and responsibility of employees.

Proposed Response: The City of Pasadena agrees with the recommendation. The City has extensive written policies and has, in many individual areas, reviewed and updated specific policies and procedures. The City is committed to updating our accounting policies and procedures. Pasadena's fund balance policy was updated in 2011, a consultant reviewed financial operations and made recommendations, and a consultant will be used to assist with a comprehensive review and full documentation of accounting policies and procedures. As the City moves forward with an Enterprise Resource Planning (ERP) solution, business practices and their related documentation will also be reviewed and updated. The City intends to hire a consultant to assist with this documentation within six months. This recommendation has been partially implemented.

Grand Jury Recommendation 5: Cities should establish a policy requiring policies and procedures to be reviewed annually and updated at least once every three years.

Proposed Response: The City of Pasadena agrees with the recommendation and will implement as part of the response to Recommendation 4 and by bringing forward a formal policy. The City intends to hire a consultant to assist with this documentation within six months. This recommendation has been partially implemented.

Grand Jury Recommendation 6: Cities should review and update policies and procedures for reporting fraud, abuse and questionable practices including a practical mechanism, such as a fraud hot line, to permit the confidential, anonymous reporting of concerns.

Proposed Response: The City of Pasadena agrees with the recommendation and has taken a number of steps to create a fraud, waste, and abuse hotline. It is anticipated that this hotline will be available in about one month.

Grand Jury Recommendation 7: Cities should periodically review and update internal control procedures over financial management.

Proposed Response: The City of Pasadena agrees with the finding and although policies and procedures are in place, improvements can always be made. This will also be part of the actions discussed in recommendation #4. The City intends to hire a consultant to assist with this documentation within six months. This recommendation has been partially implemented.

Grand Jury Recommendation 8: Cities should undertake a full-scale competitive process every five years for the selection of an independent auditor.

Proposed Response: The City of Pasadena agrees with the recommendation and last conducted a full scale, competitive process in both 2009 and 2011. The City's current contract is a three-year contract with two, one-year optional

extensions. The City will conduct a full scale competitive process in compliance with this recommendation. This recommendation has been fully implemented for a number of years.

D. Employee Compensation

On page 93 of the Grand Jury report is a section suggesting that greater transparency and accountability in the area of employee compensation is needed. While the Grand Jury did not list it as a recommendation in the structure of the report, they did make the statement, "City councils and members of the public should annually review the actual compensation received by employees of their city." The report does provide two items to promote this. First, Exhibit 2 is a list of the number of employees with compensation over \$200,000 and each city's population. Pasadena is listed with eight employees receiving over \$200,000. Further details are provided in Appendix C.

Proposed Response: The City of Pasadena agrees with the recommendation. The City, for a number of years, has listed all salary ranges by position on its public website. This information can be viewed at www.cityofpasadena.net under the Human Resources, Classification/Compensation pages. The direct link is: <http://agency.governmentjobs.com/pasadena/default.cfm?action=agencyspecs>

It has been the practice of the City to review salaries and total benefit packages as part of the labor negotiation cycle, normally upon the expiration of memorandums of understanding with bargaining units. Additionally, the impact of compensation is evaluated with each annual budget cycle. This recommendation has been partially implemented.

The City supplies actual compensation information to the State Controller's Office annually. The City encourages the public to review this website at: http://www.sco.ca.gov/compensation_search.html

Recommendations and Required Responses (6 of 17 required)

In Exhibit 12 is a recap of the 17 recommendations in the report and specifically those recommendations that required responses. It notes that the City of Pasadena's response is only required for six of the seventeen recommendations, four in the Fiscal Health section, none in the Governance Practices section, and two in the Financial Management section; however, it was the recommendation of the County Grand Jury staff that cities complete both individual responses as done above and also for this section even though it is redundant. For this reason, we provided responses to all 17 recommendations as noted in the previous section of this report.

Additional Information

Lastly, the Grand Jury report included general information about AB187. This legislation authorizes the California State Auditor to develop a high risk local government agency audit program for the purpose of identifying, auditing, and issuing reports on any local agency which the State Auditor identifies as being at high risk for waste, fraud, abuse, and mismanagement or as having major challenges associated with its economy, efficiency, or effectiveness. As this is recent legislation, the program is still being developed.

Upon submission of the City's response, it is the City's understanding that the Presiding Judge will review the responses and then have them placed on the Civil Grand Jury website for public viewing. A future Civil Grand Jury may choose to review and conduct further investigations related to this one.

COUNCIL POLICY CONSIDERATION:

The actions being taken by the City in regard to the issues highlighted by the Civil Grand Jury are all consistent with the City Council's strategic plan goal to maintain financial responsibility and stability.

FISCAL IMPACT:

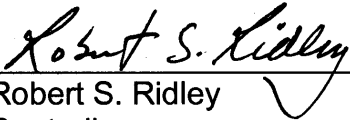
There is no fiscal impact as a result of this action nor will it have any indirect or support cost requirements. The anticipated impact to other operational programs or capital projects as a result of this action will be none.

Respectfully submitted,



ANDREW GREEN
Director of Finance

Prepared by:



Robert S. Ridley
Controller

Approved by:



MICHAEL J. BECK
City Manager

Attachment:

Attachment 1 –Cities of Los Angeles County Fiscal Health, Governance, Financial Management and Compensation Report